LEGISLATIVE AUDIT COMMISSION

Review of
Illinois Student Assistance Commission
Two Years Ended June 30, 2005

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REVIEW: 4265
ILLINOIS STUDENT ASSISTANCE COMMISSION
TWO YEARS ENDED JUNE 30, 2005

FINDINGS/RECOMMENDATIONS - 9
IMPLEMENTED - 7
ACCEPTED - 2

REPEATED RECOMMENDATIONS - 3

PRIOR AUDIT FINDINGS/RECOMMENDATIONS - 9

This review summarizes the audit of the Illinois Student Assistance Commission for the two years ended June 30, 2003, filed with the Legislative Audit Commission May 18, 2006. The auditors performed a financial audit and compliance examination in accordance with State law and *Government Auditing Standards*. The auditors stated that the financial statements were fairly presented.

The Illinois Student Assistance Commission was established through the Higher Education Student Assistance Law in 1957. Ten persons are appointed by the Governor to serve as Commission members without compensation for a term of six years, except for one member who serves for a term of two years. The Commission was created to establish and administer a system of financial assistance through loan guarantees, scholarships and grant awards for residents of the State of Illinois to enable them to attend qualified public or private institutions of their choice within Illinois.

Larry E. Matejka was Executive Director of the Commission during the audit period. He retired on December 31, 2006 after 26 years of service in that position. Andrew Davis became the new Executive Director on January 1, 2007. Mr. Davis served as an ISAC Commissioner from October 2005 until September 2006 when he was named Special Assistant to the ISAC Executive Director.

The average number of full-time equivalent employees was:

Division	2005	2004	2003
Executive	48	47	45
Client Relations	2	8	7
Program Services	96	96	94
Business and Financial Services			
Claims & Collections	106	104	107
Accounting Services	38	42	40
Management Information Services	65	61	59
Human Resources	11	10	10
Administrative Services	17	17	17
Total Full-time Employees	**383**	**385**	**379**
Full-time equivalent part-time employees	19	19	8
Illinois Designated Account Purchase Employees	**130**	**132**	**136**

Total Employees	**532**	**536**	**523**

Expenditures From Appropriations

Appendix A presents a summary of appropriations and expenditures for the two-year period under review. The General Assembly appropriated $651,042,400 to the Illinois Student Assistance Commission in FY05: $392,250,800 from the General Revenue Fund; $190,000,000 for the Federal Student Loan Fund; and $68,791,600 from the Student Loan Operating Fund and other funds. This represents a $56.7 million, or 8%, decrease over FY04. The Commission expended a total of $560,715,797 in FY05, compared to $551,635,580 in FY04 and $573,316,031 in FY03. Significant changes in expenditures from FY04 to FY05 are as follows:

- The funding for MAP was moved to GRF which accounts for the increase in grant awards under GRF and the decrease in grant awards under the Education Assistance Fund. Overall MAP grant awards fell in FY05 by about $1.6 million.
- The increase of $26.7 million in expenditures in the Federal Student Loan Fund is due to an increase in payment to lenders for loans that are uncollectible.
- The reason for the decrease of $11 million in expenditures in the Student Loan Fund was the last payment on working capital borrowed from the Fund was made in FY04.
- The Federal Reserve Recall Fund ended in FY04 resulting in a decrease of $4.2 million in expenditures.
- The I Teach program ended in FY04 resulting in a decrease of $2.1 million in expenditures.

Lapse period spending during FY05 was $13.9 million, or 2.5% of total expenditures. Delayed billing was the reason for the majority of lapse period spending.

Cash Receipts

Appearing in Appendix B is a summary of cash receipts of the Commission during the period under review. Total cash receipts increased from $292,541,000 in FY04 to $297,681,000 in FY05. Defaulted student loans repurchased by the lender were higher in FY05.

Property and Equipment

Appearing in Appendix C is a summary of property and equipment transactions of the Illinois Student Assistance Commission during the period under review. The balance decreased from $15,799,000 as of July 1, 2003 to $14,849,000 as of June 30, 2005. Of the June 30, 2005 balance, $21,011,000 is in ISAC buildings and the underlying land.

Guaranteed Loan Program

The Illinois Student Assistance Commission guarantees loans for educational expenses made to Illinois residents by banks, savings and loans, and credit unions. The Commission has responsibility for eligibility verification, processing default payments and collection of defaulted loans. Under a reinsurance agreement, the federal government has assumed at least 95% of the cost of defaulted loans provided that default rates do not exceed established limits.

The Commission supplied the information for Appendix D which summarizes the guaranteed loans outstanding at the end of FY06 and FY05. The amounts are overstated by unreported payments made directly to lenders. Accrued interest on loans is not included. Also shown is information on payments to lenders, notes receivable on defaulted loans and collections on defaulted loans.

Notes receivable from defaulted borrowers include all defaulted loans excluding death, bankruptcy and disability claims since the inception of the program. The amount is reduced by total collections on these loans since the inception. There is no provision for doubtful or uncollectible amounts.

Accounts Receivable

Accounts receivable for FY05 were $767,477,000 compared to $490,515,000 in FY04. The chart below details the amounts receivable in each category:

	2005	2004
Inter-governmental	$ 28,234,000	$ 16,700,000
Student loans	671,392,000	420,231,000
Accrued interest on loans	45,786,000	39,408,000
Accrued interest on investments	1,749,000	6,771,000
Other	20,316,000	7,405,000
TOTAL	**$ 767,477,000**	**$ 490,515,000**

The Illinois Designated Account Purchase Program (IDAPP) continues its efforts to grow the business and reach improved economies of scale. IDAPP originated/purchased $1.2 billion and $953 million in FY05 and FY04, respectively. The current portion of the overall student loan portfolio balance outstanding at year-end was $671 million in 2005 and $420 million in 2004.

Awards and Grants

The Illinois Student Assistance Commission administers a variety of nonrepayable financial assistance programs. A summary of these scholarships and grants awarded during the audit period appears in Appendix E. The number of awards increased from 200,179 in FY04 to 210,954 in FY05. However, the amount of awards and grants decreased from $383.2 million in FY04 to $379 million in FY05.

Illinois Designated Account Purchase Program

The Illinois Designated Account Purchase Program (IDAPP) is a self-supporting program whereby the Commission purchases guaranteed student loans from eligible lenders to reduce their lender collection and administrative costs. Generally, IDAPP does not purchase loans which are more than 90 days delinquent.

The Program is accounted for as a proprietary fund. At June 30, 2005, the fund had total assets of $3.9 billion. The table appearing in Appendix F presents a statement of net assets at June 30, 2005 and 2004.

Appendix G presents a summary of revenues and expenditures for the Designated Account Purchase Program.

College Illinois!

College Illinois! is a prepaid tuition program approved in 1997 to provide Illinois families with an affordable tax-advantaged method to pay for college. Prepaid tuition contracts will allow participants to prepay the cost of tuition and mandatory fees at Illinois public universities and community colleges at today's prices. Benefits of the contracts can also be used at private and out-of-state colleges and universities. Contracts can be purchased in a lump sum payment or in installments. As of June 30, 2005 the Program had 42,847 contracts.

Total assets in the prepaid tuition program at June 30, 2005 were $647,931,491. However, the program is operating at a current fund deficit of almost $30.5 million. According to an actuarial evaluation report, the present value of the Program's assets together with the present value of expected future payments is $111.7 million less than the present value of payments expected to be made by the program. The program is addressing the deficit and has added a premium to contract prices during each of the last four enrollment period to partially amortize the current actuarial deficit.

Accountants' Findings and Recommendations

Condensed below are the nine findings and recommendations together with the Commission's updated responses from Theresa Morgan, Chief Financial Officer, sent via email on March 1, 2007. There were three repeated recommendations.

Accepted or Implemented

1. Only make payments for efficiency initiative billings from line item appropriations where savings would be anticipated to occur.

<u>Finding:</u> The Commission made payments for efficiency initiative billings from improper line item appropriations. The Commission was not billed for efficiency initiatives in FY04 but did receive one efficiency initiative billing in FY05 for $16,335.

The Commission reported that while the billing invoice was dated January 19, 2005, the Commission did not discover the amount due until July or August 2005. Further, staff reported it had no prior information regarding savings that were going to occur, nor has the Commission performed an analysis of the efficiency savings by CMS.

Commission staff indicated that since payment was being processed so late – August 2005 – the Commission took the funds where funds were remaining.

Response: Implemented. Any future invoices received for efficiency payments will be charged to the appropriate line items.

2. Take a comprehensive look at IDAPP's entire financial reporting process and make changes needed to comply with the requirements of the bond indentures. IDAPP should prepare the year-end financial statement work in a more timely manner in order to allow sufficient time to have the audited financial statements issued prior to the due dates. (Repeated-2001)

Finding: The Illinois Designated Account Purchase Program (IDAPP) did not comply with several bond indentures that require IDAPP to deliver audited financial statements to the Trustees no later than 120 days after year-end (October 28th).

During an examination of the compliance requirements of the revenue bonds, revenue notes, and letters of credit, the requirement for audited financial statements to be issued within 120 days after year-end (by October 28) to bond Trustees was not met during FY04 and FY05. The FY04 audited financial report was not delivered until January 2005 and the FY05 report had not been delivered as of the end of fieldwork November 4, 2005.

According to Commission management, the delay is due to the growing complexity of the program coupled with the number of parties involved in the financial reporting process.

Response: Accepted. IDAPP will work to improve the timeliness of completion of the annual financial statements to better meet the reporting requirements of those older indentures that have a filing date requirement. Since 1996, newer indentures have been written in a manner to provide more flexibility that better suits the timing of the current process. As the older bonds that had indentures containing unrealistic requirements are retired, the impact of this issue should decrease over time.

Updated Response: Accepted. Only one indenture remains which requires that audited financial statements be delivered within 120 days after year-end. The Commission has improved timeliness in completing the financial statements and will continue to work with external parties regarding timely reporting to allow us to comply with this requirement.

Accepted or Implemented - continued

3. Take a comprehensive look at the entire financial reporting process to determine the changes necessary to prepare draft financial statements in accordance with generally accepted accounting principles. (Repeated-2003)

Finding: The Commission's draft financial statements (Illinois Student Assistance Commission, Illinois Designated Account Purchase Program (IDAPP) and Illinois Prepaid Tuition Program) required numerous additional revisions to comply with generally accepted accounting principles. The auditors noted the following:

- The Commission did not adequately disclose contingent liabilities related to federal noncompliance as a result of a review conducted by the Department of Education.

- The Commission did not adequately disclose in its financial statements deposit and investment risk disclosures required by Government Accounting Standards Board (GASB) Statement No. 40. Investments totaled $837 million at June 30, 2005.

- The Commission did not adequately disclose take-out agreements for demand revenue bonds. The disclosures did not support the classification of certain debt issuances as noncurrent. Demand revenue bonds totaled $280 million at June 30, 2005.

Commission officials stated that they were unable to prepare complete and accurate draft financial statements because of changes in key management personnel at IDAPP, complexity of the GAAP package review process with the Illinois Office of the Comptroller, and unfamiliarity with the backup documents required to provide sufficient audit evidence for the new GASB Statement No. 40 reporting requirements.

Response: Accepted. The Commission made all efforts and was in constant communication with the Illinois Office of the Comptroller and the auditors prior to the end of the fiscal year to ensure that the year-end process was timely and accurate. The Commission is committed to working with the Illinois Office of the Comptroller and the Office of the Auditor General to complete financial statements accurately and in a timely manner and will continue to review our internal procedures to determine if additional modifications can be made to assist in timely and accurate reporting.

Updated Response: Implemented. The Commission has reviewed internal procedures and implemented changes to address the timely and accurate submission of financial statements. We do not anticipate that this finding will be repeated.

4. Obtain and adequately review a copy of an independent review of computer systems maintained by third-party service providers on an annual basis. (Repeated-2003)

Finding: The Commission did not obtain independent reviews of an externally controlled computerized system used to service portions of its student loan portfolio. Without a review, the Commission did not have complete assurance that the information system controls necessary to prevent errors or irregularities from occurring were established and operating effectively at all times.

The Commission utilized seven third-party service providers to service a significant portion of its student loan portfolio. Each of the service providers used their own system to record accrued interest, cash collections and adjustments and to ensure that the program is in compliance with the Department of Education regulations for the Federal Family Education Loan Program.

Of the total student loan portfolio of $3.56 billion in 2005, $2.36 billion (67%) was serviced by the seven third-party service providers. The Commission did not obtain nor did it review reports (i.e. SAS 70 – Report on the Internal Controls in Place and Tests of Operating Effectiveness) to determine if controls were effective for one of the seven service providers who serviced approximately $670 million for the Commission during fiscal year 2005.

The Commission stated that they have been in contact with the service provider requiring them to provide a SAS 70 report. Based on our review, the SAS 70 has not been received and was also not provided during the prior audit for the period ending June 30, 2003.

Updated Response: Implemented. The Commission has implemented additional internal review procedures to ensure that all independent third-party service provider reviews have been submitted. We do not anticipate that this finding will be repeated.

5. Amend policies to require all employees to maintain time sheets in compliance with the Act.

Finding: The auditors noted the Commission's 277 salaried employees did not maintain time sheets in compliance with the Act. Employees' time is tracked using a "negative" timekeeping system. No time sheets documenting the time spent each day on official State business to the nearest quarter hour are maintained for these employees.

Commission management stated they believed the current system of reporting benefit usage by full-time salaried employees was sufficient under the Act.

Updated Response: Implemented. The Commission implemented a time reporting process as of July 1, 2006, which complies with the State Officials and Employees Ethics Act.

6. Deposit funds within the time frame required by the statute or as provided in the approved reasonable extension period for deposits.

Accepted or Implemented – concluded

Finding: Cash refunds are not being deposited timely in accordance with State statute. Based on an examination of 60 batches of cash refunds, 6 batches (10%) totaling

$42,093 were not deposited on time. The batches were deposited from 1 to 7 days late. The late deposits all occurred in fiscal year 2004. No late deposits were noted in fiscal year 2005.

Management stated the delays were due to questions on the application of the refunds. Delays in depositing funds result in a loss of interest income to the Commission and increase the risk of loss or theft of State receipts.

Updated Response: Implemented. The Commission resolved this finding in FY05 and all deposits have been made in accordance with state requirements since then. We do not anticipate that this finding will be repeated.

7. Establish a program of college savings or seek legislation to remedy the statutory requirement.

Finding: The Commission has not established a program of college savings instruments for Illinois citizens. The auditors determined the Commission has not implemented a college savings program for Illinois citizens in accordance with the Higher Education Student Assistance Act.

According to Commission management, the Commission has not established a program of college savings instruments for Illinois citizens because the State Treasurer's office already created a college savings program (Bright Start).

Response: Partially Accepted. A college savings program was established by the Commission in accordance with this statute, the ICAN program. This program, however, was discontinued in 2002 due to lack of activity. The Commission will seek legislation to repeal the act.

Updated Response: Partially Accepted/Implemented. An amendment to HB3568 will be introduced to repeal this act.

8. Continue to collateralize uninsured deposits in accordance with State statute and include collateralization requirements in compliance with State statute in its investment policies.

Finding: At June 30, 2004, cash on deposit for the Illinois Prepaid Tuition Program had a carrying amount and bank balance of $634,665. Of this amount, $100,000 was insured through the FDIC.

Commission officials stated that these deposits remain in a bank account for a very short period of time. They are funds deposited in the lock box in transit to the State Treasurer's money market account. Following State regulations the Commission picked a bank to operate the lockbox after a very extensive RFP process. The bank selected is considered the largest bank in the country and agency officials believed that further collateral was not necessary. However Commission management indicated that they began collateralizing deposits in accordance with State statute in FY05.

Updated Response: Implemented. The Commission resolved this issue in FY2005. We do not anticipate that this finding will be repeated.

9. Strengthen internal controls by implementing a policy requiring supervisory review and approval of all credit memos and other non-cash journal entries to its accounts prior to posting to the general ledger.

Finding: The Commission did not have adequate internal controls over credit memos and other non-cash journal entries to accounts.

As noted by Commission's internal audit department and during our review of internal controls, the Illinois Designated Account Purchase Program (IDAPP) did not have adequate internal controls over credit memos issued and other non-cash entries. IDAPP does not require that a responsible official, or other supervisory personnel to review credit memos and other non-cash entries to accounts prior to being posted to the accounts. The amount of credit memos issued and non-cash journal entries made in FY04 and FY05 was not readily available.

IDAPP officials stated that they converted to a new computer system and have not implemented adequate controls over the approval of credit memos and other non-cash entries to accounts.

Response: Accepted. In December 2005, IDAPP management enhanced system security and controls to ensure that credit memos and non-cash entries are properly approved and reviewed and that an audit trail is available through system reports.

Updated Response: Implemented. The Commission put controls in place in December 2005 to address this issue. We do not anticipate that this finding will be repeated.

Emergency Purchases

The Illinois Purchasing Act (30 ILCS 505/1) states, "The principle of competitive bidding and economical procurement practices shall be applicable to all purchases and contracts ...." The law also recognizes that there will be emergency situations when it will be impossible to conduct bidding. It provides a general exemption for emergencies "involving public health, public safety, or where immediate expenditure is necessary for repairs to

State property in order to protect against further loss of or damage ... prevent or minimize serious disruption in State services or to insure the integrity of State records, or to avoid lapsing or loss of federal or donated funds. The Chief procurement officer may promulgate rules extending the circumstances by which a purchasing agency may make 'quick purchases', including but not limited to items available at a discount for a limited period of time."

State agencies are required to file an affidavit with the Auditor General for emergency procurements that are an exception to the competitive bidding requirements per the Illinois Purchasing Act. The affidavit is to set forth the circumstance requiring the emergency purchase. The Commission receives quarterly reports of all emergency purchases from the Office of the Auditor General. The Legislative Audit Commission is directed to review the purchases and to comment on abuses of the exemption.

During FY04 and FY05, ISAC filed three affidavits for emergency purchases totaling $1,294,244 as follows:

- $1,253,672 to extend a contract for electronic data processing until the RFP process is complete; and
- $40,572 for a software upgrade purchased at a discount.

Headquarters Designations

The State Finance Act requires all State agencies to make semiannual headquarters reports to the Legislative Audit Commission. Each State agency is required to file reports of all its officers and employees for whom official headquarters have been designated at any location other than that at which official duties require them to spend the largest part of their working time.

The Agency indicated as of July 2005 that no employees were assigned to locations other than official headquarters.